Directorate of
Intelligence

~~Secret~~

25X1

India: Economic Ties With the USSR Likely To Revive

25X1

An Intelligence Assessment

~~Secret~~

NESA 84-10174
May 1984

Copy 401

Page Denied

Directorate of Intelligence

Secret [redacted] 25X1

India: Economic Ties With the USSR Likely To Revive [redacted] 25X1

An Intelligence Assessment

This paper was prepared by [redacted] 25X1
Office of Near Eastern and South Asian Analysis,
with contributions from [redacted] 25X1
Comments and queries are welcome and may be
directed to the Chief, South Asia Division, NESA,
[redacted] 25X1

Secret
NESA 84-10174
May 1984

Declassified in Part - Sanitized Copy Approved for Release 2012/01/19 : CIA-RDP85T00314R000100080004-0

25X1

India: Economic Ties With the USSR Likely To Revive

25X1

Key Judgments

Information available as of 1 March 1984 was used in this report.

India's faltering trade with the Soviet Union is likely to revive in the next two to three years. Its payments for military purchases from Moscow will rise, perhaps sharply, and its exports to the USSR will recover. Indeed, Indo-Soviet trade may reach a new high as both governments try to balance bilateral payments. 25X1

Moreover, the recent surge in Indian criticism of the Soviet Union will abate as export opportunities increase. Many Indian exporters and economic analysts, stung by sharp cutbacks in Soviet purchases of Indian goods in late 1982 and 1983, will again see the USSR as a reliable trading partner when India sells Moscow agricultural products and manufactured goods that it cannot easily market in other countries. 25X1

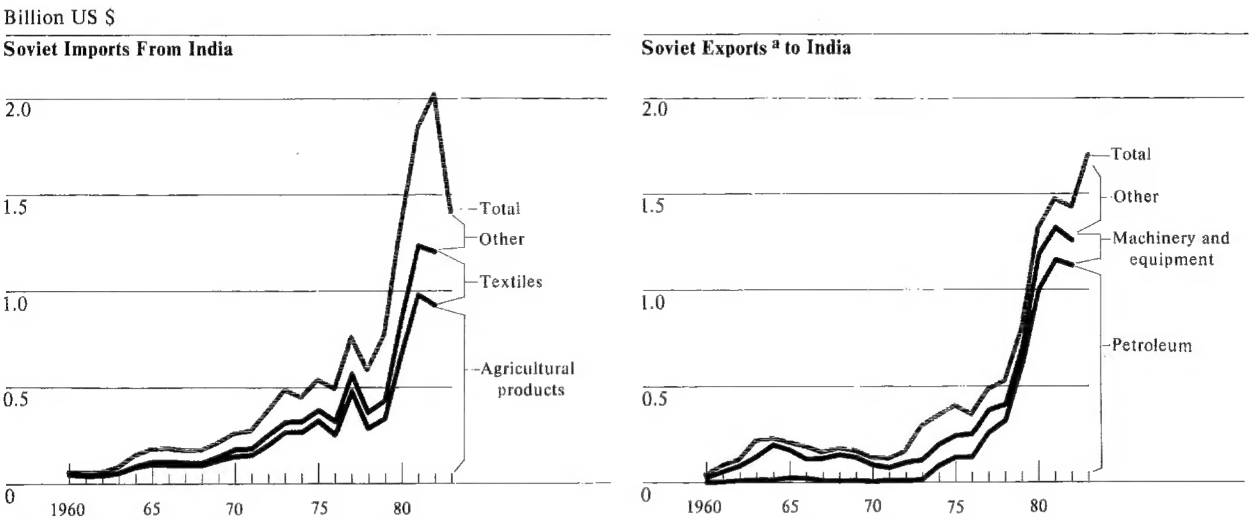
India's overall balance-of-payments position will deteriorate, however, if military payments to the Soviet Union reach $1 billion a year and if New Delhi's petroleum exploration continues to be unsuccessful. New Delhi would then have difficulty balancing the bilateral account through increased exports alone and would probably shift some petroleum purchases from the USSR to Western suppliers. The increased hard currency trade deficit would coincide with increased debt service payments to the International Monetary Fund and to commercial banks and with stagnation in Western concessional aid. Indian officials would probably attribute the resulting payments strains to US "tightfistedness" toward international financial institutions rather than to their own military purchases.

25X1

NESA 84-10174
May 1984

25X1

Figure 1
India: Trade With the USSR, 1960-83



[a] Most military sales are excluded.

25X1

302452 (A04431) 3-84

[redacted] 25X1

India: Economic Ties With the USSR Likely To Revive [redacted] 25X1

Sharp cutbacks in Soviet purchases of Indian goods in late 1982 and 1983 led Indian exporters and economic analysts to reevaluate the gains from economic agreements with the USSR. We believe that mounting payments for purchases of Soviet military equipment will soon stimulate a growth in Indian exports, however, and help sustain Indian economic and political links with Moscow. [redacted]

The Principle of Bilateral Balance

India's economic relations with the Soviet Union are governed by agreement to balance all bilateral payments for imports, exports, and debt service. All payments, whether commercial or noncommercial, are made in Indian rupees through the Indian banking system. Neither party has any need to pay nor opportunity to earn hard currency. The current agreement, signed in December 1980, continues through 1984. [redacted]

The obligation to balance bilateral payments stimulates trade because it obliges Moscow to buy from India so that India can pay for purchases of Soviet goods. An unintended rupee surplus by either side is a liability. It constitutes a loan from the surplus country to the deficit partner because it cannot be used to purchase goods from other countries. [redacted]

To avoid large or persistent imbalances, the two governments negotiate quantity or value targets for commodities as part of annual and five-year trade agreements, according to press reports [redacted] The actual value of imports and exports depends on separate contracts signed and implemented by public- and private-sector organizations. Trade targets are not always met, but until recently payments imbalances were probably small or temporary.[1] [redacted]

[1] Appendix A provides further detail about bilateral trade and payments agreements. [redacted]

Trade Patterns

Long-Term Trends

Bilateral trade patterns have changed markedly since the mid-1950s. Initially, machinery and equipment accounted for one-half to three-fourths of Indian purchases as New Delhi built up its heavy industrial base, but Indian manufacturers can now supply much of the country's requirements. Officials and businessmen spurn Soviet capital goods for better quality equipment and more advanced technology from Western suppliers. Growth in bilateral trade was nearly stymied by the mid-1970s, according to US Embassy officials, because Indian import payments were not high enough to sustain a rapid growth in exports. [redacted] 25X1

A new phase in New Delhi's economic relations with Moscow began in the mid-1970s, in our view, when the Soviet Union agreed to sell India more petroleum. Several increases in the quantity and price of petroleum provided Moscow with higher rupee earnings. Growth in Indian exports to the Soviet Union is now determined primarily by Indian purchases of Soviet crude oil and petroleum products. [redacted] 25X1 25X1 25X1

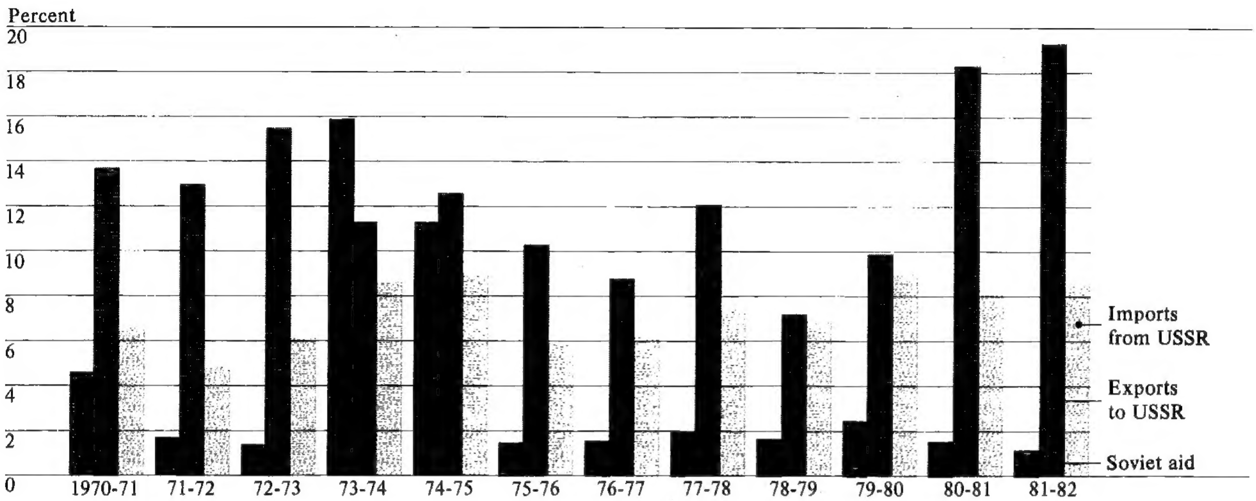
Soviet economic aid now plays only a minor role in stimulating trade. As much as two-thirds of imports in the 1960s were financed by Soviet credits, according to published trade and aid data. In recent years, Soviet aid has financed less than 5 percent of Indian nonmilitary purchases from the Soviet Union. [redacted] 25X1 25X1 25X1

[redacted] 25X1 25X1

25X1

25X1

Figure 2
Soviet Share of Indian Trade and Aid, 1970-82



Note: Based on Indian data for fiscal years beginning in April. Aid estimates are for disbursements of economic aid and suppliers credits. Military aid and trade are excluded.

[redacted] 25X1

302545 (A04480) 4-84

Recent Disruptions

The Boomlet. Soviet trade organizations began a buying spree in India in 1981, according to trade data and press reports, when faced with hard currency shortages but ample rupee earnings from growing petroleum sales. They splurged on manufactured consumer goods and even paid higher-than-equivalent world prices for some agricultural products, such as cashew nuts. [redacted] Moscow encouraged Western suppliers to sell to India for reexport to the USSR. [redacted]

With the explosion in Soviet purchases, the Indian trade surplus grew much more rapidly than planned. Indian corporate giants and subsidiaries of multinational firms expanded output of manufactured consumer goods to cater to Soviet demand and take advantage of export subsidies and production incentives offered by the Indian Government, according to press reports. In 1982 slippage in the international price of crude oil restricted growth in the value of Indian imports from the Soviet Union. [redacted]

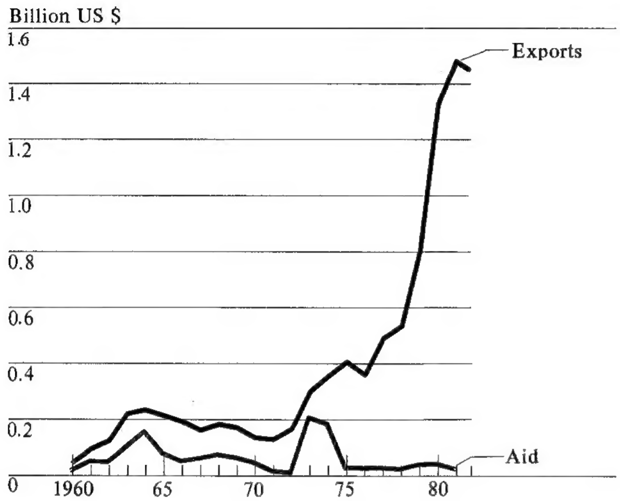
We believe the Indian trade surplus with the Soviet Union in 1982 was larger than needed to cover military and civilian debt service. At its peak, sometime in late 1982 or early 1983, the payments imbalance probably exceeded the equivalent of $500 million. India was not receiving anything tangible in return for increased exports because its surplus earnings could not be used to buy goods from third countries. Instead, bilateral agreements required New Delhi to lend large sums of money to the Soviet Union to cover the payments imbalance. [redacted]

25X1
25X1
25X1

The Crash. The large payments imbalance provoked corrective measures by both governments that embittered bilateral economic relations. The trade agreement for 1983, which was negotiated in late 1982, attempted to reduce the payments imbalance by targeting a sharp increase in Indian imports and only a slight increase in Indian exports. Indian imports did not increase as much as planned and then only with

25X1

Figure 3
Soviet Economic Aid and Exports, 1960-82



Note: Soviet exports to India are based on Soviet trade data for the calendar year. Indian utilizations of Soviet economic aid are based on Indian data for fiscal years beginning in April. Military aid and trade are excluded.

302546 4-84

25X1

the help of a midyear agreement for additional crude oil. Indian sales dropped substantially below those in 1982. New Delhi even banned exports to the Soviet Union for two weeks—a move we attribute to official interest in obscuring the size of lending to Moscow during the fiscal year ending March 1983.

The adjustment has been painful for Indian exporters, who bore the brunt of bringing the accounts into balance. According to the Indian press, sales of cashew nuts, pepper, and Virginia tobacco were sharply reduced. Industries that had expanded to serve the Soviet market—especially detergents, cosmetics, pharmaceuticals, and woolen knitwear—were forced to curtail output. Exports of cotton textiles also slumped, though a prolonged strike in Bombay mills also contributed to the decline. Businessmen complained bitterly about lost sales.

Trade is beginning to revive following partial success in reducing the payments imbalance. The Indian surplus may now be less than $250 million, according to IMF estimates. The bilateral agreement for 1984 calls for substantial increases over 1983 trade in both imports and exports. Editorials in the business press express relief even as they warn that targets may, again, be missed. The USSR has agreed to maintain the quantity of crude petroleum exported to India at the enhanced level negotiated for 1983, although it has not abandoned efforts to balance payments through increased sales of machinery and equipment. 25X1

25X1

Forthcoming Military Stimulus to Indian Exports
In our view, India is entering a third phase in its economic ties with the Soviet Union. The overall trading relationship will be sustained not by aid-financed Indian imports of machinery and equipment or by Indian purchases of petroleum, but by Indian military purchases. Sharply rising payment obligations will generate new export opportunities, assuming a bilateral payment agreement continues and obliges Moscow to purchase Indian goods. 25X1

25X1

By our estimates, annual payments to the Soviet Union for military purchases will escalate over the next several years, perhaps by as much as $700 million. Deliveries under agreements signed since early 1980 and those now being negotiated will greatly increase the Indian burden of downpayments and debt servicing, even with the low interest rates and long repayment terms that Moscow offers. 25X1

25X1

Arms Imports and Exports

We estimate that India has ordered more than $14 billion in arms from the USSR and Western suppliers since 1970, nearly $10 billion since Prime Minister Gandhi's return to power in 1980. The more recent orders indicate, in our view, a strong government commitment to building a more modern and powerful military, concern about deficiencies in Indian defense industries, and a reaction to US arms sales to Pakistan. Orders from the USSR have included aircraft, helicopters, missiles, armored fighting vehicles, artillery, and warships. [redacted]

Although New Delhi remains willing to purchase limited quantities of selected high-technology arms from the West, our analysis indicates that India continues to rely on the USSR for most of its military imports. Of the nearly $10 billion in purchases since early 1980, 70 percent were from the Soviet Union, according to our estimates. [redacted]

[redacted]

India's total military exports have been small—only about $28 million in 1982, according to a press statement by India's Defense Minister. Our research indicates that such sales consist largely of small arms and ammunition, light artillery, trucks, and various quartermaster supplies. Until recently, New Delhi had not, in our view, aggressively sought to sell arms and military equipment abroad because of the high priority of satisfying large domestic defense needs, the low level of production, and the poor quality of many Indian products. [redacted]

25X1

25X1

New Delhi decided in late 1981, however, to try to increase India's military exports in view of its bleak foreign exchange prospects, according to Indian press accounts. New buyers are being sought largely from traditional markets in the Middle East, Africa, and South and Southeast Asia. [redacted]

[redacted]

25X1

25X1

25X1

25X1

Increased Indian exports of military equipment could help balance part of the increase in military payments. According to press reports [redacted] New Delhi is seriously considering plans to develop its aircraft industry to export MIG-21 components and spare parts to the USSR and its clients. A prompt decision to proceed could produce earnings of $500 million a year within several years. This estimate of potential export earnings, obtained from the Indian press, is consistent with our estimate of the size of the world market for MIG-21 parts. India's new Defense Export Promotion Council is also looking into other ways to increase military exports.[2] [redacted]

[redacted]

The Political Impetus for Trade

India's economic agreements with the Soviet Union provide a symbol of mutual cooperation as well as a mechanism for regulating trade. Until recently, in our judgment, most Indians have viewed longstanding bilateral payments arrangements as evidence of Soviet support. For Moscow, the political benefits of being seen as a friend of India probably outweigh any economic disadvantages. [redacted]

25X1

25X1

25X1

Much of the propaganda value to Moscow, in our analysis, is based on a misunderstanding. Indians typically talk of the right to pay in rupees and

25X1

25X1

erroneously infer that it is easy to pay the Soviet Union. Until recently, the obligation to adjust trade flows to balance payments was rarely highlighted. [redacted]

The political overtones of bilateral trade induce both governments to try to achieve the required payments balance by expanding imports or exports. A planned cutback would be interpreted by the Indian press as evidence of a souring political relationship. [redacted]

[redacted]

In our view, trade benefits are a strong but secondary aspect of India's overall relations with the Soviet Union. The core of the relationship, according to US Embassy officials, lies in the conviction that the most immediate danger to Indian security comes from Pakistan. New Delhi feels assured of a powerful ally to help deter Pakistan from attacking or to provide military supplies and political support if there is another Indo-Pakistan war. We believe that looser economic ties would attenuate the widespread perception that the Soviet Union is a friend of India and could eventually lead to cooler political relations. Close ties will persist, however, so long as India perceives a threat from Pakistan and to a lesser extent from China. [redacted]

Economic Costs and Benefits

Disruption of Indian exports has led Indian businessmen and economic journalists to reassess the gains from trade with the Soviet Union. Improved prospects for 1984 have not curtailed the debate. According to our analysis of press reporting, the tenor of extensive comment is that India got a good deal until recently but may be handicapped in the future by the need to balance bilateral payments. [redacted]

Advantages for India

Markets. Access to additional export markets is the principal benefit India receives from its economic agreements with the Soviet Union, in our judgment.

New Delhi obtains goods it really wants in exchange for products, some of which are of little interest to other countries. A director of the Cotton Textile Export Promotion Council noted that "our product is just not competitive for the hard currency areas." Failure to fill Western textile quotas despite idle Indian looms bears him out. Even those optimistic about export prospects doubt that Indian pharmaceuticals would succeed in other markets. Press analysis, which may reflect a few outdated academic studies, estimates that only 20 to 25 percent of Indian exports to the USSR could be sold readily in Western markets. [redacted]

Political Fringe Benefits

25X1

Trade helps finance Soviet political and propaganda activity in India, according to Embassy and Consulate General assessments and press reports. Part of the purchase price for commodities such as tea has sometimes been returned to Indian traders for disbursement to political parties. Press reports in 1983 contend that the Soviet Union willingly accepted lower quality rice than ordered—with most of the price difference going to the coffers of the Communist Party of India. In our judgment, opportunities for such payoffs are a byproduct of the overall economic relationship. We doubt that Moscow alters the types or quantities of items in trade agreements to finance noneconomic activities. [redacted]

25X1 25X1 25X1

We doubt that Indo-Soviet trade agreements intentionally facilitate Moscow's efforts to obtain advanced technology in violation of Western export controls. The commodity protocols attached to trade agreements are probably too general to identify sensitive items. [redacted]

[redacted]

25X1

25X1 25X1 25X1 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/19 : CIA-RDP85T00314R000100080004-0

In our view, Moscow probably would not buy so much from India if it were not obliged to balance bilateral payments, although purchases of some agricultural commodities would continue under any payment regime. Moscow would probably curtail purchases of manufactured consumer goods if it had to pay hard currency. The USSR, however, has a political interest in sustaining a trading presence in Third World countries, especially India. [redacted]

Ease of selling to the Soviet Union is an important advantage for Indian suppliers with weak export promotion skills. For some products, including textiles, Soviet buyers come to India to negotiate bulk purchases. They are not fussy about quality, according to Indian officials and businessmen. Indian manufacturers do not have to seek out customers or keep abreast of changing tastes. For industrial products, long-promised Soviet help with sales to third countries is apparently under way at last. An article in December 1983 attributed to the Soviet Deputy Minister of Foreign Trade notes that Moscow has begun to import equipment from Soviet-aided industries in India for use in Soviet-aided projects in Bulgaria and Turkey. [redacted]

Useful Imports. Indian imports from the Soviet Union have been goods that New Delhi considers essential—aid-financed equipment to develop public-sector industries at first, wheat briefly in the early 1970s, and petroleum recently. Fertilizer and newsprint purchases have relieved domestic shortages, and military equipment has been supplied on favorable credit terms since the early 1960s. Protracted and sometimes fruitless negotiations indicate that New Delhi resists sales offers, even aid offers, that do not fit its policy preferences.[3] [redacted]

On several key occasions New Delhi has turned to the Soviet Union only after access to Western supplies or financing was curtailed. Moscow's support for the Bokaro steel plant followed US refusal in 1965 to aid a public-sector industry. Soviet military supplies filled the void caused by virtual cessation of Western military aid to India after the 1965 Indo-Pakistan war. Similarly, when US economic aid was curtailed after the 1971 Indo-Pakistan war, Indian licensing regulations encouraged importers to turn to the Soviet Union. The USSR supplied wheat in 1973, when the Indian harvest was poor and world supplies tight. The Soviet offer of additional petroleum in 1980 came when the Iran-Iraq war made New Delhi uncertain whether it could maintain deliveries from traditional suppliers. [redacted] 25X1

India gets a bargain on its military purchases. [redacted] 25X1

[redacted] 25X1

Moscow also assists India with domestic military production, including some advanced equipment. In our judgment, Indian officials believe that Soviet deliveries are less likely to be disrupted in case of war with Pakistan than those from other suppliers. [redacted] 25X1

Disadvantages for India

Instability. Risk of a sharp decline in sales is a major disadvantage of trade with the Soviet Union, according to press reports of Indian business opinion. Soviet purchases of commodities such as tobacco, jute, cotton textiles, and storage batteries vary widely from year to year. Producers who cater primarily to the Soviet Union are especially vulnerable. Several press articles counsel against expanding capacity to meet increased Soviet demand lest a subsequent curtailment lead to idle capacity and unsalable stocks. [redacted] 25X1

Impressed by recent cutbacks, Indian exporters apparently believe that the Soviet market is even more unstable than markets in other countries. Sales to the USSR, unlike those to other countries, must be curtailed when Indian imports of Soviet goods slow down. Even when bilateral trade is growing, Indian exporters cannot influence Soviet purchasing decisions. [redacted] 25X1

Prices. India probably suffers a slight price disadvantage in its nonmilitary transactions with the Soviet Union. The Soviets bargain hard when negotiating

[3] In 1966 Prime Minister Gandhi caved in when the USSR insisted on using Soviet rather than Indian consultants for the Bokaro steel plant. This was a highly publicized exception to the general pattern of Indian sales resistance. Several Soviet-aided industrial projects have performed poorly, but New Delhi wanted them when it ordered them. [redacted] 25X1

purchases of manufactured products that India has difficulty selling elsewhere. A large contract for Indian railway cars fell through in the 1960s over a price dispute, and some Indian suppliers resent the low prices offered for cotton textiles. Several studies estimate that India has paid higher than world prices for machinery imports from the Soviet Union or paid lower prices only when quality was also lower. Most studies judge that the prices India receives for its agricultural exports, however, are equal to or higher than world levels, and the USSR purchases tea at competitive auctions. Academic investigations of India's terms of trade are inconclusive because they cannot take full account of quality differences.

Information about petroleum prices is also inconclusive. The unit price for Soviet-supplied crude delivered to India in 1981/82 was slightly higher than the average price from other countries; in 1982/83 it was slightly lower. India's Petroleum Minister announced in 1982 that India pays a 5-cent-per-barrel surcharge on Iranian or Iraqi crude supplied by the Soviet Union but pays lower than world prices for Soviet crude.

Soviet economic aid does not compensate for any price disadvantage. The USSR contributes less than 2 percent of the total economic aid India receives. In addition, Soviet credits are much more expensive than near-grant loans available from the International Development Association and some bilateral donors. Since 1977 government-to-government credits have been for a term of 20 years including a three-year grace period, with interest at 2.5 percent. Soviet suppliers credits, which are provided for equipment not covered by project aid, finance 85 percent of the purchase price with interest at 4 percent of the outstanding balance. Similar credits offered by Western governments are more expensive but are available in larger amounts.

Scarce Indian Government funds have been used to promote exports to the Soviet Union. Export and investment subsidies helped stimulate sales of manufactured products during 1981 and 1982, according to press analyses. The surge in processing at Kandla Free Trade Zone was a response to tax waivers as well as to increased Soviet demand. Other suppliers benefit from tax concessions, preferential import licenses, and cash payments that are offered for export sales but not for sales in the domestic market. Government export promotion policy, however, does not give any preference to the Soviet Union. 25X1

Hard Currency Spillover. The USSR has long been accused of disrupting Indian markets by reexporting Indian products—particularly tea, tobacco, and oilcakes—to third countries at a discount. Academic studies of trade data conclude that Moscow probably has engaged in some "switch trade," but the amounts have been minor and caused little reduction in India's export earnings. 25X1

25X1

India spends some hard currency in order to export to the Soviet Union even though all bilateral transactions are conducted in rupees. For example, it imports raw cashew nuts from hard currency suppliers so that it can sell processed nuts to the Soviet Union. Exports of manufactured goods also have a high import content—as much as two-thirds of export value for industries located in free trade zones. 25X1

25X1

25X1

We disagree with the judgment of many journalists that India is always harmed when it spends hard currency to earn rupees from the Soviet Union. India did lose when rupees accumulated in late 1982 and early 1983 and were not spent on imports. Normally, however, the additional hard currency import expenditure helps produce goods that are exchanged for commodities that would otherwise be purchased with hard currency. It also generates some employment and income in India. 25X1

Technology. India risks technological obsolescence as a result of trade ties with the Soviet Union. Public-sector officials have become acutely aware of the danger of basing industrial expansion on inferior Soviet equipment. They have turned to Western suppliers for major components of industrial plants originally established with Soviet support. Economic aid 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/19 : CIA-RDP85T00314R000100080004-0

tied to Soviet equipment is now sought primarily in areas such as thermal power plants and some aspects of steel production where Soviet quality is competitive. Much of the criticism of Soviet equipment comes from Indian suppliers who want to sell their own products or from bureaucrats who are partly responsible for the poor performance of Soviet-supplied factories. Nevertheless, the complaints seem valid. Most Soviet equipment is poorly made, outdated, energy inefficient, ill suited to Indian humidity, and, in addition, the supply of spare parts is irregular.

The temptation to buy Soviet remains even though purchasers clearly prefer Western technology. Soviet trade officials are now dangling tentative offers of credit and long-term buyback contracts to increase sales of machinery and equipment to the Indian private sector. If an acceptable price can be negotiated, Indian textile manufacturers may yet buy Soviet textile machinery to obtain a long-term order for cloth, even though they believe that the quality of the resulting product would preclude sales in Western markets.

Popular Indian View of the Future. The balance of gains and losses from bilateral economic agreements is now shifting to India's disadvantage, in the view of many businessmen and economic journalists. Unaware of the magnitude of forthcoming military payments, they counsel looser economic ties with Moscow. According to a consensus emerging in the Indian business press:

- Petroleum imports cannot sustain continued growth in bilateral trade. Increased domestic production of crude oil will probably reduce import requirements. In any case, the Soviet Union will probably not be willing to curtail its hard currency sales of petroleum to offer additional supplies to India. It may not even be willing to sustain deliveries at current levels.

- India does not need other products the Soviet Union is willing to offer. Expansion of domestic production will reduce fertilizer import needs. More important, Indian industry has outgrown its Soviet mentor. It can absorb advanced Western technology to increase domestic production and compete successfully in world markets. Technical links with Western companies are already growing in response to liberalized economic policies.

- The obligation to balance bilateral payments means that exports to the Soviet Union cannot grow if imports stagnate or fall. To sustain sales, India may have to import inferior Soviet machinery and equipment.

- There is a way out of the dilemma. India can break the link between imports and exports by revising bilateral agreements with the Soviet Union and settling any payment imbalances in hard currency. Most observers doubt that sales to the Soviet Union would fall very much; they expect India to run a payments surplus. Others are willing to endure short-term losses to avoid permanent technological inferiority. 25X1 25X1

The business community's scenario is incomplete because it ignores arms purchases that will increase the scope for growth in Indian exports to the Soviet Union. Policymakers have not attempted to correct the analysis, probably because they are reluctant to highlight the growing magnitude of Indian military payments. So far as we know, however, no senior Indian official has endorsed the call for elimination of bilateral payments agreements with the Soviet Union. 25X1 25X1

Implications for the United States

Closer Ties With the USSR

Increased military payments will strengthen India's economic ties with the Soviet Union, in our judgment. They provide an opportunity to increase Indian exports within the framework of balanced bilateral payments and will help overcome the problems businessmen anticipate. At a minimum, producers of low-quality consumer products will increasingly value the Soviet market. 25X1

New Delhi risks increased dependence on Moscow's policy whims if military components become a significant part of Indian export earnings. The USSR would probably retain a veto over the destination and quantity of Indian military exports produced under Soviet production licenses. 25X1

The new trading patterns will tend to limit mounting criticism of the USSR, which has barely begun to jeopardize business support for political cooperation with Moscow. India will not need to abandon the rupee payment agreement, which symbolizes Soviet friendship, to increase sales. Business complaints about irregular Soviet purchases and inferior industrial machinery will be heard less frequently as Indian exports increase and the Indian payment surplus vanishes. The bitter experience of late 1982 and 1983, when cutbacks in Soviet purchases led to disenchantment with the benefits of trade with the USSR, will probably not be repeated in this decade. [redacted]

In the scenario most favorable to US interests, New Delhi could strengthen ties with both Moscow and Western countries. If our lower estimates of military payments prove correct and if petroleum exploration efforts are soon very successful, savings in the oil import bill will permit India to pay for increased purchases of Western technology while it balances its account with the Soviet Union. We are not confident, however, that New Delhi will be able to reduce its oil import requirements. Domestic production is leveling off, expensive exploration efforts have not yet yielded new discoveries, and consumption is still growing. [redacted]

Balance-of-Payments Strains

The financial burden of military payments is more likely to lead to a deterioration in India's overall balance-of-payments position and impinge on trade with the United States. If military payments to the Soviet Union approach $1 billion a year, New Delhi may have difficulty balancing the bilateral account through increased exports. It could transfer some of the financial burden to hard currency accounts in any of several ways:

- New Delhi could balance the cost of military purchases by shifting petroleum imports from the Soviet Union to other suppliers. The adjustment could be made quickly and with a minimum of administrative complications. India imported more than $1.1 billion of petroleum from the Soviet Union in 1982; annual payments for military imports will not exceed $1 billion in this decade, according to our estimates.

- New Delhi and Moscow could agree to revise their bilateral payments agreement. We believe that any revision would continue to permit the use of rupees for most transactions. Only imbalances beyond an agreed high amount—probably the equivalent of about $150-250 million—would be settled in hard currency.

- New Delhi could buy goods for hard currency for reexport to the USSR. [redacted] 25X1

The additional hard currency expenditure would increase strains on India's international financial position. Indian policymakers may be unable to obtain more concessional aid and unwilling to seek more commercial loans to ease balance-of-payments problems. In the scenario most unfavorable to Indian growth prospects, they may impose new curbs on imports needed to modernize and expand Indian industry. [redacted] 25X1

25X1

Role of Concessional Aid

Military payments to the USSR could increase friction between Washington and New Delhi over the use and adequacy of concessional aid. Loans and grants provided by Western aid donors indirectly help finance Indian military payments to the Soviet Union by easing India's overall balance-of-payments position. With international lending agencies strapped for funds, questions about India's need for concessional aid would probably intensify. Indian policymakers would argue that balance-of-payments strains would be even more severe if New Delhi turned entirely to more expensive Western suppliers of military equipment. [redacted] 25X1

25X1

Indian officials will probably accuse the United States of contributing to any balance-of-payments strains by reducing support for Indian borrowing from international financial institutions. The rise in military payments to the USSR will coincide with increased payments to the IMF and to commercial bankers. Total debt service could rise to more than $3 billion in 1987 compared with $1.9 billion at present, while concessional aid receipts are likely to stagnate. We believe that Indian officials are far more likely to blame their economic problems on the United States than on their own military purchases. In the propaganda battle in India, the United States—not the Soviet Union—would lose. [redacted] 25X1

Appendix

Arrangements for Bilateral Trade and Payments

The Principle of Bilateral Balance

Since substantial trade began in the 1950s, India and the Soviet Union have agreed to balance all bilateral payments for imports, exports, and debt service. Published agreements provide that all payments be made in Indian rupees through the Indian banking system. [redacted]

An informal understanding—and probably an explicit commitment—requires both governments to adjust trade each year to achieve a balance in payments. The published agreement is less specific. It merely requires that any rupee balances or debt remaining when the five-year agreement expires be used to purchase goods within the next year or be "settled in such other ways as may be agreed upon." We believe, however, that unpublished agreements supplement the published text. [redacted]

Trade

Targets. India and the Soviet Union plan their trade to avoid a large or persistent imbalance in bilateral payments. According to press reports [redacted] annexes to the five-year trade agreements and annual protocols set quantity or value targets for exports by each country. In recent years, the target for total Indian exports has been slightly higher than the target for Indian imports; a merchandise surplus is necessary to earn rupees to repay Soviet economic aid. According to press reports and official statements, midyear negotiations sometimes provide for additional trade quantities or commodities—a rice-for-oil "barter," for example. [redacted]

Commodity lists and projected trade totals are public information. The text of the current five-year agreement calls for India to export 93 categories of goods such as: tea, including processed tea; medicines and pharmaceutical preparations; spectacle frames; polygraphic equipment; and machinery and equipment manufactured at industrial enterprises built in India with the assistance of the USSR. Planned Indian imports from the USSR are in 42 categories such as: crude oil; diesel oil; urea; and power and electrotechnical equipment, turbines, generators, and spare parts. Press reports, which are probably based on official briefings, list several commodities included in annual trade protocols and note the projected value of Indian imports and exports. We do not have the text of any annual trade protocols. [redacted]

Detailed trade projections are not published. [redacted] We are confident that detailed lists are still prepared because press reports occasionally mention the target for a particular commodity. To provide guidance about production and sales, trade associations need to know—and apparently do know—the targets relevant to private business in their area of responsibility. [redacted]

Some transactions are excluded from trade agreement targets. Published commodity lists—[redacted]—do not mention trade in services or in military equipment. [redacted]

25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1

Trade targets are a statement of intention, not a commitment to buy or sell. Shipments are arranged only after contracts for specific quantities, prices, and delivery dates are signed, according to observed trade practices, the text of agreements, and press accounts. Target negotiations are nevertheless meaningful, in our judgment. We believe that Indian officials consult extensively with public-sector organizations and with trade associations before agreeing to export and import targets. [redacted]

Actual Trade. According to press reports and trade data, imports and exports usually differ, sometimes substantially, from trade targets. Unanticipated changes in prices, requirements, or availabilities affect performance. Disputes over price sometimes delay the signing of contracts, and scheduled delivery dates are not always met, according to press reports, Embassy comment [redacted] In addition, the mechanism for monitoring trade seems inadequate. [redacted]

Government organizations arrange much of the trade with the Soviet Union. Petroleum trade and distribution is a government monopoly in India. According to press reports, public-sector industries arrange imports of aid-financed equipment that they use. The Minerals and Metals Trading Corporation handles trade in fertilizer as well as minerals and some metals. Another government agency, the State Trading Corporation, serves as middleman in exports of many private-sector agricultural and manufactured products. Negotiations for exports of cotton textiles—which are manufactured in both the public and private sectors—are coordinated through a trade association, according to press reports, but contracts are signed with individual suppliers or trading firms. [redacted]

The private-sector role in bilateral trade is growing, in our judgment. Indian brokers have long bought tea at auctions on behalf of the USSR and now also arrange exports of high-quality rice. The Soviet Union sells computers through an Indian trade organization, according to press and Embassy reports. The USSR recently authorized a private Indian firm to open a general trade office in Moscow, according to press reports. High-ranking Soviet officials met with delegations of leading Indian industrialists in 1983 and proposed—in very general terms—long-term orders, 25X1 technical cooperation, and credit. The major private business association in India is studying the potential for imports of machinery and equipment from the Soviet Union, according to press and Embassy reports. [redacted]

Trade Data. Trade targets and bilateral trade data include some third-country goods supplied on Soviet 25X1 account. This is especially important for petroleum. Middle Eastern crude purchased by the Soviet Union and shipped directly to India is recorded as an export 25X1 to India in Soviet statistics and an import from the Soviet Union in Indian statistics. Agricultural attache reports indicate that some Indian rice sales recorded as exports to the USSR were shipped directly to 25X1 Southeast Asia. [redacted] 25X1 25X1 Except for petroleum and grain, we estimate annual bilateral trade accounted for by goods that are not physically handled by both 25X1 countries is less than $100 million. [redacted]

25X1

Indian and Soviet trade data tell the same story but do not match exactly. Most discrepancies can be explained by the time goods are in transit, freight charges on Indian imports, and our conversions of rubles and rupees to dollars. Neither country publishes military trade data. Soviet export data may include some dual purpose items, such as trucks, that are not included in published Indian data. [redacted] 25X1

The analysis in this paper is based primarily on Soviet data because they are far more current and less subject to major revision than Indian data. We have also used older Indian statistics and press reports of partial or preliminary Indian data announced by 25X1 government officials or compiled by trade associations. [redacted] 25X1

Payments

Bank Accounts. The Bank for Foreign Trade of the USSR maintains accounts with Indian commercial banks and with the Reserve Bank of India, India's

central bank, to handle bilateral transactions. All receipts and payments for goods and services, with the possible exception of military transactions, are handled initially through commercial banks. When Soviet funds at a commercial bank are greater than necessary for current operations, the surplus is transferred to the Central Account at the Reserve Bank. When funds in a commercial account are inadequate, they are replenished by transfers from other commercial banks or from the Central Account. [redacted]

Some Soviet funds are always held in the Central Account at the Reserve Bank to facilitate payments through commercial banks. [redacted]

Technical Credits. When funds in the Central Account are inadequate to replenish accounts in commercial banks and pay for Soviet purchases in India, the shortage is covered by a "technical credit"—a loan from the Government of India. Published trade agreements and Indian Government budget documents mention technical credits but do not explain them. [redacted] Extensions of technical credit are recorded in the Indian budget as government expenditure. Repayments are recorded as government receipts. The net balance adds to the budgetary deficit for the fiscal year. [redacted]

[redacted]

25X1

25X1

25X1

Military Payments. Indian military payments are taken into account when planning trade adjustments to achieve an overall balance, in our judgment. Prime Minister Gandhi's principal secretary, who is in a position to know, told US Embassy officials that military payments were included when calculating the Indian surplus. [redacted] 25X1

25X1

25X1

Exchange Rate. The ruble-rupee exchange rate is determined by the value of a specified basket of currencies. In 1978 Moscow and New Delhi agreed to change the rate whenever the value of the currency basket changes by more than 3 percent, according to official statements. The main provisions of the 1978 agreement are probably still in effect. We do not know whether minor changes have been made to widen the 3-percent band or change the composition of the currency basket in line with revised arrangements for determining the international value of the rupee. [redacted] 25X1

25X1

25X1

25X1

25X1

The exchange rate affects bilateral payments even though all transactions are in rupees. The amount of Soviet aid and the prices for some services and military items are negotiated in rubles. A variable exchange rate helps protect Moscow against a decline in the purchasing power of rupees India pays under long-term contracts and for debt servicing. [redacted]

25X1